

## **CHAPTER 2**

### **LITERATURE REVIEW**

Malaysian services sector are categorized under final services and intermediate services. Sectors that are classified under final services are; wholesale and retail trade, hotels and restaurants, utilities and government services, while finance, insurance, transport and communication fall under intermediate services. Within the services sector, final services produce the main component of real GDP at 36.6 percent in 2004. The dominant sectors are wholesale and retail trade, hotel and restaurant which make up 14.3 percent of real GDP (Table 3).

This paper will provide the information about the distributive trades, the indicators used in measuring the productivity and the role and its significance to the Malaysian economy.

#### **2.1 Distributive Trades**

Distributive trades is a link sector between the production in the economy or manufacturers and their end users and is indispensable as its contribution to the economy is increasing. It contributes significantly in terms of generating output and employment. The average output growth and the employment growth was 5.1

percent and 1.4 percent respectively during the 1999-2004 period. The productivity growth of distributive trade has been positive with 3.6 percent over the 1999-2004 period except during the health crisis in 2003.

Distributive trades comprises all linkage activities that channel goods and services down the supply chain to intermediaries for resale or to final buyers.

The linkages may be :

- direct or indirect between 2 parties (or levels) or more than 2 parties (or levels) within the chain;
- real physical processes or electronic transactions as defined under the relevant laws;
- In person or electronic transactions as defined under the relevant laws; and
- transactions that may or may not involve transference of title of ownership to the goods and services.

Distributive traders include wholesalers, retailers, franchise practitioners, direct sellers, product manufacturers, suppliers, who channel their goods in the domestic market, and commission agents or other representatives including those of international trading companies of all nationalities. (see Appendix 1).

(Products and services governed by other Acts: petroleum products, pharmaceutical, medicinal and orthopaedic products, toxic substances and explosives, arms, ammunitions, agricultural raw materials and live animals are subject to other acts and regulations for specific reasons).

**Table 3: GROSS DOMESTIC PRODUCT BY SERVICES SECTOR**

	1960	1970	1980	1990	1995	2000	2002	2003	2004p
	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
<b>Intermediate Services</b>	<b>9.7</b>	<b>13.7</b>	<b>14.5</b>	<b>16.6</b>	<b>20.2</b>	<b>20.2</b>	<b>22.8</b>	<b>23.8</b>	<b>23.8</b>
Finance, insurance, real estate and business services	6.1	8.8	8.1	9.7	11.9	11.9	14.3	15.1	15.0
Transport, storage and communication	3.6	4.9	6.4	6.9	8.3	8.3	8.5	8.6	8.7
<b>Final Services</b>	<b>34.9</b>	<b>29.9</b>	<b>30.4</b>	<b>24.7</b>	<b>25.6</b>	<b>25.6</b>	<b>34.2</b>	<b>33.9</b>	<b>33.6</b>
Utilities	1.3	1.9	2.3	1.9	2.7	2.7	4.0	4.1	4.1
Wholesale and retail trades, hotels and restaurants	15.7	13.8	12.5	11.0	12.7	12.7	14.9	14.3	14.3
Government services	6.5	11.6	13.0	9.7	8.1	8.1	7.2	7.4	7.2
Other services	11.4	2.6	2.6	2.1	2.1	2.1	8.0	8.0	7.9
<b>Total Services</b>	<b>44.6</b>	<b>43.6</b>	<b>44.9</b>	<b>41.3</b>	<b>44.2</b>	<b>45.8</b>	<b>57.0</b>	<b>57.6</b>	<b>57.4</b>

Source: Bank Negara Report : Various Issues

P = preliminary

## **2.1 Wholesale Trades**

In defining wholesalers, the French National Commission for Listing Activities and Products are referred to, which states that wholesalers are traders who sell products to other professionals. Wholesalers are located in the marketing system between producers and consumers and provide the boundary between supply and demand. In other words, wholesalers have multiple functions (trading, stocking, processing, transporting, etc.) that help to supply the downstream part of the marketing chain with products adapted to the customers' demand (Vernin 1998: 109).

Consequently, wholesalers are not defined by the quantity they handle but rather by their customers. Apart from buying and selling products, wholesalers also generate administrative and financial flows which have to be managed (Vernin 1998: 113-115).

- Sourcing and assortment supply. This is the most fundamental activity of wholesalers in urban markets: catering for a wide variety of products coming from different regions and countries so as to satisfy the demands of their customers. Wholesalers have to analyse the market and consider what kind of product to buy in what quantity. In this phase merchants take the marketing risk of buying products they may not be able to sell later on.
- Selling products. Wholesalers are free to choose to whom they will sell. It has already been mentioned that a great majority of wholesalers claim not to sell to the general public because it is not their role. Customers of terminal wholesale markets are



**Table 4: CONTRIBUTION OF SERVICES SECTOR IN EMPLOYMENT**

	1960	1970	1980	1990	1995	2000	2002	2003	2004e
	% of Employ- ment	% of Employ- ment	% of Employ- ment	% of Employ- ment	% of Employ- ment	% of Employ- ment	% of Employ- ment	% of Employ- ment	% of Employ- ment
<b>Intermediate Services</b>	4.3	4.3	5.9	7.5	8.0	8.0	11.4	11.6	11.6
Finance, insurance, real estate and business services	n.a	0.9	1.6	3.4	3.4	3.4	6.2	6.4	6.4
Transport, storage and communication	n.a	3.4	4.3	4.31	4.6	4.6	5.2	5.2	5.2
<b>Final Services</b>	33.4	27.2	32.3	37.9	34.4	34.6	38.8	36	38.1
Utilities	n.a	0.8	0.6	0.7	0.6	0.6	0.9	0.9	0.9
Wholesales and retail trade, hotels and restaurants	n.a	10.9	14.9	18.71	16.8	17.0	17.3	14.3	16.9
Government services	n.a	11.7	13.7	12.8	10.0	10.0	10.4	10.3	9.8
Other services	n.a	3.8	3.1	5.7	7.0	7.0	10.2	10.5	10.5
<b>Total Services</b>	37.7	31.5	38.2	45.4	37.0	48.4	50.2	47.6	49.7

Source: Bank Negara Report: Various Issues  
E estimate

generally independent retailers (owning a shop or touring outdoor retail markets), institutional customers (restaurants, hotels, catering firms, hospitals, etc.) and other secondary wholesalers or wholesaler-retailers delivering to other locations than the city nearby. However, some wholesalers also have an export activity. Moreover, supermarkets also rely, occasionally, on traditional wholesalers to balance their requirements with available supply.

- Marketing and merchandising. With their extensive knowledge of their suppliers' products and their customers' demands, wholesalers can provide the key link between the two. Wholesalers can try new products and develop existing markets for certain products. The quest for customer loyalty and a greater emphasis on food quality and origin are also forcing wholesalers to remain customer focused (Pepineau 1999).
- Flow management. As traders, wholesalers need to manage financial flows (some wholesalers extend credit to both their suppliers and their customers) and administrative flows, including risk management (payment default) and stocks. Wholesalers are also a decisive link in the circulation of price information between producers and consumers.

### **2.1.1. The Unique Roles of Malaysian Wholesale Markets**

Malaysia's agricultural production, especially the food sector, is characterised by many, small and scattered nature; likewise many small entrepreneurs also represent the retailing sector. In these scenario, wholesale markets would continue to play significant roles in the future as major accumulation of stocks, price formation, dissemination of market information, sorting, grading, redistribution, account settlement, food safety and hygiene and food security.

Long traditional family linkages, especially among the Chinese businessmen characterises the present operation of wholesale markets in Malaysia. Any effort to make changes normally will encounter resistance, if not objection. An improved wholesaling operation essentially should focus on the intricacies of social-economic reengineering in a multi-society framework. The tasks ahead are more challenging since the entering of the new millennium – a digital era, e-commerce, k-economy among other things that the complexity of development planning and implementation would be compounded over the years.

Wholesale market's roles and it functions are very vital in the social-economic development. This is more so, when estimated 75 percent of the agricultural produce is transported through wholesale markets before it reaches retailers and the end consumers. Currently, there are 15 wholesale markets, throughout the country. Most of the wholesale markets are located in the centre of major cities. The wholesale

market's roles in providing the supply for the growing population in the urban areas is becoming a major challenge these days, as a result of inflation.

In Malaysia, the marketing system for fresh produce is characterised by the prevalent role of traditional private sector market intermediaries. In the domestic market, the bulk of the produce is channelled through traditional marketing, ranging from farm level collectors, lorry operators, to wholesalers in the urban centre, other than through the establishment of farmers' markets.

The price formation process at the wholesale market does not lend itself to an open price discovery mechanism that can provide signals to producers in their decision making process. Perishables are marketed largely on consignment basis whereby prices received by farmers are only known after the produce is sold in a day or two after delivery. The risk in such a system therefore lies with the producers. While the consignment system has stood the test of time as a fairly effective system, this system has made farmers helpless price taker after delivery. This contributes to inadequate market transparency manifested in terms of lack of market information, most importantly on prices, and to a lesser extent in respect of variable and seasonal preferences of consumers, quality standards, timing and quality required.

## **2.2 Retail Trades**

The retail industry in Malaysia currently is characterised by several retail formats; each format has its own problems and developmental needs.

- a) A very large format retail stores comprise hypermarkets and large supermarkets. Foreign retail operators basically own these large format stores. Examples are Carrefour, Giant, Tesco and Jusco. At the current moment this format of retail store is the fastest growing in terms of sales, not only in Malaysia but also in this region.

### **Hypermarket and Large Supermarket**

A self-service distribution store with sales floor area of 5,000 square meters or more, selling a very wide variety of mainly consumer goods, comprising a mix of food and non-food products, in a range of transaction sizes or quantities and in different forms of packaging.

- b) The second format is the medium sized supermarkets and/or departmental stores, basically owned by local operators. Currently, this format of stores, especially supermarkets, is badly hit by the influx of hypermarkets in the country.

### **Departmental Stores**

A distribution stores with sales floor area of varying sizes, usually engaged in retailing an extensive assortment of consumer goods that are departmentalized by gender, age or lifestyle, through self-service or with sales assistance, generally under one common store management. A departmental store may include a supermarket of not more than 2,000 sq.m.

### **Superstore/Supermarket**

A self-service distribution store with sales floor area of 2,000 square meters to less than 4,500 square meters retailing a wide variety of mainly consumer goods, comprising a mix of food and non-food products.

- c) The third format is the smaller speciality stores, including pharmacies, garments, electrical goods, accessories and multitude of different merchandise offered for sale.

### **Specialty store**

Stores dealing with one main brand name / product / line of goods associated with one product. They may specialise on :- food catering and restaurant services outside hotel premises; food-drink-tobacco (e.g. food and beverages); household/personal goods

(e.g. furniture, household electrical appliances, healthcare products, optical goods, footwear, clothing and apparel, sports goods, books, jewellery, spices, electronic goods, etc); motorcycles-motor vehicles; small machinery (e.g. industrial, agricultural equipment for small users) pharmacy (retails mainly drugs, health and beauty care goods); electronic wholesaler / retailer (web based distributor); and others.

- d) Convenience stores and petrol station stores remain a new store concept in Malaysia. These stores represent around 9.0 percent of total retail sales and are

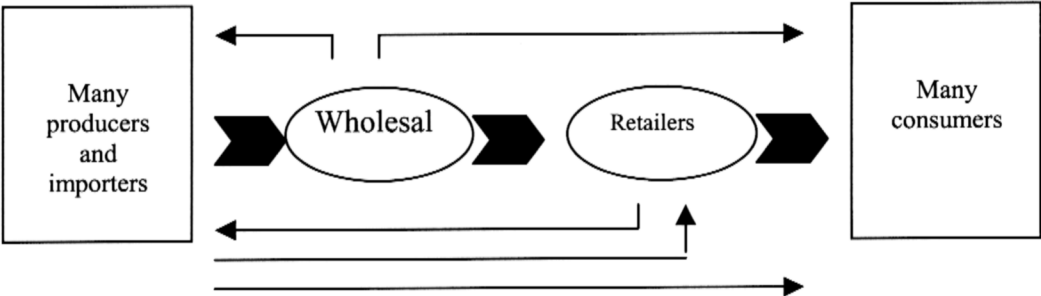
mainly located in major urban centers. Trade sources estimate that there are around 120 convenience stores and some 500 petrol station stores nationwide.

- e) Finally, the smaller provision stores, including mini markets and sundry shops, mostly located in housing areas and smaller towns and villages.

**2.4 Distribution functions in wholesale and retail trade**

As noted before, wholesalers and retailers provide an intermediation role between goods producers and consumers. Figure 1 shows an example of how wholesalers and retailers distribute a wide range of product line for customers known as a ‘sequential distribution function’ and is depicted by the bold arrows.

**Figure 1: Distribution functions in wholesale and retail trade**



*Source: Productivity in Australian's Wholesale and Retail Trade:2000*

In other cases, the distribution function may be bypassed such as producers selling directly to consumers through factory outlet sales. An occurrence identified as 'disintermediation'. As a result of forward and backward integration of the various components of distribution and the potential for continuing disintermediation, it is appropriate to see the wholesale and retail activities as part of a 'value network' rather than as sequential links in a chain.

Developments in distribution are more visible at the retail level. These include:

- the increasing attention given to meeting the needs of "income-rich, but time poor" consumers, through extended trading hours and locational convenience;
- malls seeking to make shopping a more family-oriented lifestyle outing by including food courts, cinemas and entertainment;
- the emergence of mega stores (or 'category killers'), often located in fringe areas to take advantage of low cost land for extended floor plans and parking; and
- a shift of 'traditional' retail functions to consumers (eg self-service petrol stations) and producers (eg increased reliance on brand advertising and warranties rather than advice from shop assistants).

## **2.5 Various Other Distribution Formats**

Other types of businesses not specified will be considered on the merit of each case with particular reference to their contribution to the socio-economic development of Malaysia.



### **2.5.1 Direct Seller (A door-to-door sale and a mail order sale).**

A door to door sale means the sale of goods or services involving a person or any person going from place to place not being a fixed place of business or making telephone calls; and a mail order sale means the sale of goods or services which a person conducts, either by himself or through any person authorized by him, by receiving an offer for a sale contract by mail. as refer to the Direct Sales Act 1993 and Guidelines for Application of Direct Selling Business.

### **2.5.2 Franchisor and Franchisee**

A franchisor engages in distributive trade mainly through franchisees according to the contractual agreement between them. A franchisee engages in distributive trade according to the contractual agreement with the franchisor up the supply chain. A franchise is defined under the Franchise Act 1998.

## **2.6 Wholesale and retail Regulations**

The supervision of the wholesale and retail sector falls under the supervision of the Ministry of Domestic Trade and Consumer Affairs (MDTCA) through the Committee on Wholesale and Retail Trade. The Committee was set up in 1995 to regulate and supervise the industry, including foreign participation in the sector. Approval from the Committee is needed for foreign companies wanting to set up wholesale or retail operations locally and for the opening and relocation of branches.

The Government has recently reviewed Foreign Investment Committee (FIC) guidelines to provide further flexibility on foreign equity participation in local companies. In the case of acquisitions, foreigners can own up to 70%, as long as the 30 percent (minimum) “Bumiputera” (indigenous Malays and other ethnic groups) condition is met.

FIC and MDTCA are generally flexible on the shareholder structure. However, exceptions are examined on a case-by-case basis. Other conditions placed on foreign investment in the industry include:

- Incorporation of their wholesale and retail operations locally;
  - Minimum capital requirements of RM1 million for specialty outlets, RM5 million for supermarkets, RM10 million for department stores and RM50 million for hypermarkets; and
- FIC guidelines on purchase of property by Malaysians and foreign interests.

Guidelines for new hypermarkets effective from April 2002, the government has approved a new set of guidelines for applications to open new hypermarkets in Malaysia:

- The minimum capital requirement has increased from RM10 million to RM50 million;
- Applications to build outlets should be submitted two years in advance;
- New hypermarkets cannot be built within a 3.5 kilometer radius of a housing area or a city center;

- Operations should be free-standing, which means hypermarkets must operate in their own buildings and not as part of any other complexes;
- A socio-economic impact study has to be conducted by the local authorities in the proposed area before any application is considered. The cost of the study would be borne by the applicants;
- Applications will only be considered for locations with a population of 350,000 or higher;
- Floor space should not be less than 8,000 square meters and a counter must be set up in every 1,000 square meters;
- Applicants should provide a business center for interested traders with reasonable rentals.
- With effect from January 1 2004 to January 1 2008, the government has declared that it will disallow any new foreign-owned hypermarket development and construction in Klang Valley, Johor Baru and Penang; and
- From April 2004, the Government has standardized operating hours for all hypermarkets – 10am to 10pm on weekdays and 10 am to midnight or 1am on weekends.

During the Seventh Malaysian Plan period, the wholesale and retail trade sector recorded an average annual growth of 4.2 per cent in spite of a negative growth of 3.1 per cent in 1998. The degeneration in growth during 1998 was largely due to the sharp regression in share prices and the insecurity in employment.

However, as the Malaysian economy recovers parallel with the reduction in interest rate and lessening of credit terms, such as for hire purchase of passenger cars and credit cards and the recuperation in consumer assurance, it has contributed to the growth of the distributive trade sector at 2.5 per cent in 1999 to 5.9 per cent in 2004. The employment in the wholesale and retail trade sector grew at an average annual rate of 3.3 per cent that is 1.2 million jobs in 2004 from 896,000 jobs in 1995.

Key growth drivers for the Malaysian retail industry include the gradual liberalization of the market, declining domestic production, increasing reliance on food imports and increasing tourist inflows. The food service sectors are also expected to register strong growth alongside the rising demand for convenient, healthy and international cuisine.

## **2.6 Distributive Trades Development and Prospects**

Distributive trade sector will be further improved and reinforced to take up the challenges of globalization in the Eighth Malaysia Plan period. The total number of establishment increased 31 percent from 216,400 establishments in 1998 to 284,171 in 2001. During this period, the allocation in distributive trade increases 12 percent to RM763.2 million which are utilized to provide loans and financing for small and medium scale enterprises, support the purchase of business premises in strategic locations, modernization and development and also training and consultancy services.

Towards the end of the Eighth Malaysia Plan period, strategies implemented to strengthen the performance of distributive trades are as follows:

- enhancing the competitiveness of distributive trades;
- facilitating the development of new distribution modes;
- expanding e-commerce;
- intensifying efforts to increase Bumiputera participation;
- strengthening linkages with other economic sectors;
- ensuring price stability; and
- promoting consumer education and ensuring consumer protection.

The allocation for distributive trades in the Eighth Malaysian Plan is RM763.2 million, as shown in Table 6. This allocation will be utilized to provide loans and financing for small and medium-scale enterprises, support the purchase of business premises in strategic locations, modernization and development of distributive trades as well as for training and consultancy services.

**Table 5: Development Allocation for Distributive Trade,  
1996-2005 (RM million)**

Programme	7MP		8MP Allocation
	Allocation	Expenditure	
Funds for Distributive Trade	763.5	200.0	243.0
Upgrading and Modernization of Trade Services	22.6	20.9	40.0
Business Premises	438.1	257.5	440.2
Training and Consultancy	18.8	16.2	40.0
<b>Total</b>	<b>679.5</b>	<b>494.6</b>	<b>763.2</b>

*Source: Eighth Malaysian Plan, Government Printers. 2003*